

**Testimony of
Gregory D. Johnson, EDEP, Executive Director
Dayton Metropolitan Housing Authority
Dayton, Ohio**

**Before the House Government Reform
Subcommittee on Federalism and the Census**

***“Public Housing Management: Do the Public Housing
Authorities have the Flexibility They Need to Meet the Changing
Demands of the 21st Century?”***

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Chairman Turner and members of the subcommittee, thank you for the opportunity to appear before you today to discuss the Housing and Urban Development's implementation plans for the new Operating Fund Rule. My name is Gregory D. Johnson; I am the Executive Director of Dayton Metropolitan Housing Authority in Dayton, Ohio. Dayton Metropolitan Housing Authority's mission is to assist low to moderate income residents of Montgomery County, Ohio area in obtaining decent, safe and affordable housing. Dayton Metropolitan Housing Authority's housing stock is comprised of over three thousand public housing units and oversees the administration of over twenty one million dollars in federal funds through the Section 8 Voucher Program.



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The State of Ohio has over **75** public housing authorities that will be affected by the new Operating Fund Rule. Public housing in Ohio provides over **135,651** opportunities for families to have decent, safe and affordable housing.

Background

The Quality Housing and Work Responsibility Act of 1998 (QHWRA) called on HUD to replace the older performance funding system with a new operating fund formula. In 2003, the Congressionally mandated Harvard Cost Study reported that public housing was underfunded compared to private and nonprofit owners managing comparable property serving the country's low income population. It also recommended that public housing adopt the asset-based system that the private sector uses to account for and manage its property.

A negotiated rulemaking committee wrote a rule implementing the cost study's recommendations in 2004. However, HUD has not lived up to its responsibilities under this rule. The new management requirements are being implemented in 2007, but its 2007 budget only requests enough funding for 78 percent of the subsidy amount that, according to the rule, is needed to sustain well-run public housing. With such a low proration, even some agencies that stand to gain under the new system will end up losing funding.

Housing authorities are expected to convert to the new asset-based system starting this year, but the details of that conversion are still up in the air, especially since much of the Department's proposed guidance does not implement its own rule.

Through its proposed asset management guidance, the Department is trying to micromanage how a housing authority is organized by pushing services to the sites- even though the rule clearly allows management functions to be performed centrally when they are cost effective. HUD is also trying to dictate housing authorities' organizational structure by restricting how they can spend their own money, despite language to the contrary in the rule and existing law.

As I look at the new Operating Funding Rule, there are several topics that create funding shortfalls for housing authorities across the country. These shortfall gaps can only be filled by clients (potential residents) that do not have the dollars to fill the gap. If public housing authorities are suppose to run their operations more like the private sector, then public housing authorities need the same flexibility the private sector has when it comes to running their operations.

Concerns:

A. Public Housing versus Multifamily

As part of the initiative to shift public housing agencies to asset management, HUD is requiring that housing authorities adopt financial and operational practices like those used in the Department's multifamily housing programs. This is an extension of an earlier effort to tie public housing operating costs to multifamily programs. Under the new operating fund rule, local HAs will now receive funds based on the costs of similarly situated multifamily housing in their area. One of the biggest concerns with this is unlike multifamily housing providers, public housing authorities have historically been underfunded. Since public housing rents are tied to tenants' income and limited by the Federal Brooke Amendment, housing authorities, unlike multifamily providers don't have the options to increase rent. Housing authorities have to depend on Congress for funding. Housing authorities received only 89 percent of total funding eligibility last year and may only get 78 percent in 2007, even as utility costs are rising by up to 50 percent. In contrast to public housing, private housing providers are not short funded by the federal government. Any new PBA/PBM rules must take this budget reality into account, and be flexible enough to allow housing authorities to deal with budget shortfalls as best they can. Another comparison between the two is that public housing agencies are heavily regulated whereas multifamily counterparts do not operate the same way. Just to list a few of the differences pertaining to regulations are:

- Public Housing Assessment System (PHAS)
- the annual plan

- de-concentration
- procurement
- community service
- employee compensation
- resident programs
- population housed
- public entity costs
- local mandates

B. Rent Calculation

Before the new funding rule, to calculate how much funding housing authorities needed, HUD first figured out how much they collected in rent. Under the new rule, HUD has changed the way it calculates this rental income. Housing authorities' "formula income" now includes rent that they never collected-rent on routine vacant units and units that are being modernized. This change in the rule may deprive housing authorities of \$100-\$200 million in funding eligibility each year. The rule HUD agreed to during negotiated rule making described the calculation of formula income as follows: ***"For the purpose of the Operating Fund formula this revenue is equal to the amount of rent charged to tenants minus any applicable utility allowance calculated as a per unit month (PUM) and frozen at 2004 levels."*** This means housing authorities' rental income is the amount they charge tenants. It doesn't indicate that HUD should make any changes to the existing system of estimating total resident rent.

According to this more complicated formula, HUD will now figure rental income by taking the per unit month amount of rent charged to tenants and multiplying that by the number of "eligible units." This includes not only occupied units, where tenants are actually paying rent, but also units that no one is living in-apartments that the housing authority has permission from HUD to renovate, plus the normal three percent of units that are being cleaned and repaired between tenants. This method is clearly unfair. It will ascribe income to housing authorities that they will never receive. Housing

authorities will not receive the amount of funding recommended by the Harvard Cost Study, and their residents will not be treated equally to those in the multi-family program. Well-run agencies who often have more approved vacancies for modernization projects-will be hit the hardest.

Even more alarming, this new calculation will likely discourage housing authorities from undertaking comprehensive modernization projects and improving their housing stock, because creating any temporary vacancies will mean losing rental income.

When HUD is determining whether multi-family properties will be viable, it has to calculate whether they will collect sufficient rent to cover their expenses. In other words, when HUD is evaluating these properties' revenue, it assumes that they will have no income from five percent of their units. This means public housing properties are not being funded in a manner equivalent to multifamily properties. ***How does HUD expect housing authorities to collect rent on units that are in modernization or make ready stage?***

C. Micro-Management

Housing authorities must now assign their expenses either to the central office, where they are paid by the management fee, or to the individual properties, where they become a front-line expense. The new rule clearly says housing authorities can perform front-line functions centrally if they choose-for example, having a central maintenance department for all its properties, and distributing that cost among the properties as a front-line expense.

HUD has now proposed regulations that directly contradict the new rule and the multifamily housing handbook as well as the Department's own lead architect of property base management. If HUD required housing authorities to pay for these centralized front-line expenses out of its limited management fee funds, the housing authority will not be able to afford them and will have to physically move staff out to the property-even if it's more cost effective to perform the work centrally. Organizational decisions should remain at the local level, not be micromanaged. The rule is not

ambiguous: housing authorities are authorized to perform services centrally. When those services directly support a project, they should be charged to the projects. The rule even specifies a mechanism-the fee-for-service approach-for charging centralized functions back to the properties. HUD strongly suggested that housing authorities should have a central procurement department. Under HUD's draft guidance and inadequate management fees however, it will be financially challenging for housing authorities to operate this important internal control mechanism. This could create future problems for housing authorities during audits and IG reviews.

Much of HUD's new guidance for public housing is based on the multifamily handbook. Even it specifically permits property managers to expense centralized functions as front-line costs. "If front-line management functions for several properties are performed by the staff of the agent operating out of a single office, the following conditions apply. (a) The agent *must* prorate the total associated costs among the projects served in proportion to the actual use of services."

Despite these clear statements in the rule, in the multifamily handbook, and during the negotiated rulemaking, HUD's proposed guidance specifically prohibits charging some key expenses to the front-line, even when they directly support individual properties:

1. Centralized purchasing must be paid out of the management fee.
2. Centralized inspections must be paid out of the management fee.
3. Supervisors providing front-line functions, such as a maintenance supervisor or a work order supervisor, must be paid out of the management fee.

HUD must stop ignoring its own rule and the multifamily handbook, and allow centralized functions directly supporting the projects to be expensed at the front-line.

HUD is trying to control how housing authorities can use the funds which they are provided. It wants to restrict the amount of money that can be spent on central office costs, but in so doing HUD is breaking the law and violating the intent of its own rule.

QHWRA says that housing authorities with 250 or more units can use up to 20 percent of the Capital Fund for everyday operations. This language was confirmed in the negotiated rulemaking session when Assistant Secretary Michael Liu stated, “Fungability between operating and capital funds will remain the same as provided by current statute”.

The new rule says housing authorities should be able to use excess cash flow for any eligible expenses – anything a housing authority can normally spend money on “If a project has excess cash flow available after meeting all reasonable operating needs of the property the PHA may use this excess cash flow for the following purpose:...other eligible purposes.” Under QHWRA, the central cost center is clearly considered an eligible expense. HUD agreed with this position during negotiated rulemaking when Assistant Secretary Liu said that “excess cash flow is fully fungible.” In its new guidance, HUD is essentially saying after the fact that only certain HA activities are “eligible purposes.”

The rule says that funds can be transferred from one project to another when there is “excess cash.” This provision was included in the rule because the cost study had an error rate of ± 42 percent for any one property, and housing authorities need a way to adjust for such large errors in their properties’ funding levels. HUD has now proposed, though, that a project can only be considered to have excess cash if it has two months reserve. HUD has never before mandated a reserve level prior to allowing a PHA to spend its money. The rule does not authorize this restriction, nor are multifamily properties required to maintain a two-month reserve. Also, HUD has proposed a six-month reserve limit for the central cost center, and has said that stop-loss agencies cannot spend this reserve to support the central costs center. “Provided that the PHA complied with GAAP and other associated laws and regulations pertaining to financial management (e.g., OMB Circulars), it shall have the **maximum amount of responsibility and flexibility** in implementing project-based accounting”.

D. Inadequate Funding

There are a few major points that I again would like to address that pertain to a housing authority's funding.

- HUD's new formula assumes housing authorities can collect rent on authorized vacant units;
- HUD is proposing a **78 percent** funding level;
- Public housing authorities; inflation factor does not include health care costs;
- HUD is proposing unreasonable property management fees with guidance that will micromanage the way housing authorities use their funding;
- Last but not least, asset management and bookkeeping fees in HUD's proposed guidance are one size fits all.

E. Section 8 to Asset Management

HUD is proposing, housing authorities will have to divide their Section 8 expenses into "front-line" and "central" costs. HUD will set a limit on how much of the Section 8 administrative payments can be spent on "central" costs and how much can be spent on "front-line" expenses. These "front-line" expenses, paid for through a fee-for-service, would include direct program costs such as the waiting list, income certifications and inspections, while "central" costs would be supervisory.

However, Section 8, unlike public housing, does not manage properties-so there are no front-line (or project-level) expenses. Any plan for dividing Section 8 expenses into "central" and "front-line," as HUD proposes to do, would make no sense from an asset management perspective. It is important to note that the operating fund rule specifically excludes Section 8: *"This part is not applicable to. . .the Housing Choice Voucher Program. . . or the Section 8 Housing Assistance Payments Programs."* Also, HUD's position appears to conflict with OMB Circular A-87, which describes using the fee-for-service approach as voluntary. Asset Management has nothing to do with Section 8 - a program that manages no assets. HUD should not artificially apply asset management principles to the Section 8 program and they should not be telling housing authorities

how to spend their administrative fees on programs they are already managing very successfully.

F. Capital Fund

Under existing regulations, housing authorities can use 10 percent of their Capital fund for administrative expenses and additional portions for management improvements, such as computer upgrades, and operations. HUD is now planning to require housing authorities to divide the funds used for administrative expenses into fixed amounts for central, front-line, and bookkeeping costs. It will also disallow administrative expenses on Capital funds spent on operations or management improvements. This will reduce the amount housing authorities can spend on administrative expenses and central costs.

Having to charge a fee for service for direct management of the Capital program will substantially increase accounting requirements, add payroll complications if staff are doing different kinds of work at different times and creating new paperwork. HUD has offered no evidence that this change will help housing authorities administer the Capital fund more efficiently-nor even any claim they are currently administering it poorly.

CONCLUSION

As an Executive Director of a mid-sized housing authority, I am honored to serve the people of Montgomery County, Ohio and the state of Ohio at large. I work with one hundred and eighty employees who on a daily basis attempt to provide decent, safe and affordable housing to the clients we serve. However, I am concerned the impact that the multiple restrictions on the public housing authority's ability to manage its' own finances, the change in funding calculation and imposition of the department's mandates on day-to-day operations, will impair the authority's ability to remain viable in this new conversion. Although we shall conform and be compliant with all federal mandates, I would like to leave you with one question ***"How can the families we serve on a daily basis conform to these changes without being harmed?"***

I would again like to thank you for allowing me this opportunity to address the committee with these concerns.

(Note: Dayton Metropolitan Housing Authority would like to thank PHADA for providing information.)